IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1959.

No. 883

EMBRY BROTHERS, INC., and
JAMES DRURY,

Petitioners,

versus

HOWARD L. DAVIS,
CITIZENS FIDELITY BANK AND TRUST COMPANY,
UNITED STATES OF AMERICA,

Respondents.

On Petition For Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit.

BRIEF FOR CITIZENS FIDELITY BANK AND TRUST COMPANY IN OPPOSITION TO PETITION FOR CERTIORARI

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IN THE

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EMBRY BROTHERS, INC., and
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v.

HOWARD L. DAVIS,
CITIZENS FIDELITY BANK AND TRUST COMPANY,
UNITED STATES OF AMERICA, - - - *Respondents.*

BRIEF OF CITIZENS FIDELITY BANK AND TRUST COMPANY IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

The Petition for Certiorari should be *denied* because the conclusions of law of the District Court, summarily affirmed by the Court of Appeals for the Sixth Circuit, are correct, conform to the laws of Kentucky, and do not conflict with any general principles of equity jurisprudence.

The Petitioners raise no questions of the character indicated in Rule 19 of the Revised Rules of the Supreme Court of the United States (adopted April 12, 1954).

COUNTER-STATEMENT OF QUESTIONS PRESENTED FOR REVIEW.

Citizens Fidelity Bank and Trust Company (hereafter called Citizens Fidelity) is dissatisfied with the Petitioners' presentation of the questions presented for review and hereby make its own Counter-Statement of Questions presented.

In April and July, 1952, respectively, the two Petitioners, Embry Bros., Inc. and James Drury (hereafter collectively called Embry Bros.), leased certain trucks and tractor equipment to Howard L. Davis (hereafter called Davis), a subcontractor for J. W. Bateson Company (hereafter called Bateson), a general contractor holding a large contract with the United States Army.

Litigation developed between Bateson and Davis and resulted in a compromise under which Bateson paid $20,000 into the United States District Court for the Western District of Kentucky in full settlement of the litigation. Certain payments (not now in issue) were made from this fund and there remained in the United States District Court a net balance of $13,333.34.

Davis had previously assigned, for a valuable consideration, a portion of the fund to Citizens Fidelity. He also owed substantial taxes to the United States. The total of the amount assigned and of the taxes due exceeded the balance remaining in the fund.

Embry Bros. claimed an *equitable lien* on the balance in the fund superior to the valid assignment

to Citizens Fidelity and to the tax lien of the United States.

The sole question presented is whether the District Court of the United States and the Court of Appeals of the United States for the Sixth Circuit are in *such error in a matter of such importance* as to warrant review by certiorari in holding that

(1) *Neither* the Miller Act [49 Stat. 793, *et seq.*; Title 40 U. S. C.; 40 U. S. C. A., §§ 270(a)-(d)] *nor* any Kentucky Statute *nor* the Common law created an equitable lien on the fund for the benefit of a person (Embry Bros.) leasing equipment to a subcontractor (Davis) of a general contractor (Bateson) holding a contract with the United States Army; and

(2) The Lessor (Embry Bros.) of such equipment was no more than a general creditor of the subcontractor (Davis).

COUNTER-STATEMENT OF THE CASE.

[The District Court's Findings of Fact]*

1. "On February 16, 1952, Howard L. Davis (hereafter called Davis), executed a subcontract for certain construction work on a United States Army installation in Kentucky with J. W. Bateson Company, Inc. (hereafter called Bateson), a corporation, with its principal office in Texas. On or about October 8, 1952, Bateson terminated its contract with Davis. On De-

*R. 23a-26a.

cember 11, 1952, Davis filed the present action in this court against Bateson for damages for breach of contract.

On July 31, 1956, Davis and Bateson effected a compromise settlement under which Bateson paid into this court $20,000 (hereafter called the Fund) there to abide the judgment and further orders of this Court. Certain assignees, asserted lienholders and creditors of Davis thereupon claimed various interests in the Fund, and on September 7, 1956, Bateson interpleaded, among others, Citizens Fidelity Bank and Trust Company (hereafter called Citizens Fidelity), the United States of America and Embry Bros., Inc. each of whom claimed varying interests in the Fund.

2. On August 8, 1952, a $15,000 promissory note previously executed by Davis to the order of Citizens Fidelity became due and payable and Davis failed to pay the remaining $9,000 balance then due and owing on the note. Thereafter, Davis made a payment of $445.56 on his past due promissory note and reduced the unpaid principal balance to $8,554.44. Citizens Fidelity demanded payment of the unpaid balance and notified Davis that it intended to take legal action against him to recover the balance. On January 23, 1953, Davis, in consideration of Citizens Fidelity forbearing to institute legal action against him for the remaining unpaid principal balance of $8,554.44 and interest, signed, executed and delivered to Citizens Fidelity a written assignment whereby he conveyed to Citizens Fidelity all of his right, title and interest in and to the first $9,000 to be recovered by him out of the

proceeds of his recovery in the present action then pending against Bateson.* On February 10, 1953, Citizens Fidelity notified Bateson of such an assignment, and the notice of assignment was acknowledged. The assignment is as follows:

> "KNOW ALL MEN BY THESE PRESENTS, that *Howard L. Davis,* a resident of Clark County, State of Indiana, hereinafter called the 'Assignor', in order to secure to *Citizens Fidelity Bank and Trust Company* of Louisville, Kentucky, hereinafter called the 'Assignee', payment of the sum of Eighty-five Hundred Fifty Four and 44/100 Dollars ($8554.44), representing the balance due Assignee on a promissory note in the original amount of $9000.00, plus interest thereon at the rate of 6%, which amount is justly owing by the Assignor to the Assignee, hereby
>
> "SELLS, ASSIGNS, TRANSFERS AND SETS OVER TO Assignee all and singular:
>
> (1) The First $9000.00 of the proceeds that Assignor may recover in the cause entitled 'Howard L. Davis vs. J. W. Bateson Company, Incorporated, cause No. 2527 in the United States District Court for the Western District of Kentucky, Louisville, Kentucky.'

*Embry Bros. *omits to* state that after the $15,000 promissory note became past due and was not paid Citizens Fidelity *demanded payment of the unpaid balance and notified Davis that it intended to take legal action against him to recover the balance* and that Davis, in *consideration of Citizens Fidelity forbearing to institute legal action against him for the remaining unpaid principal balance of $8,554.44 and interest* executed the written assignment [Findings of Fact (R. 24a); Affidavit of Arthur G. Baumann (R. 1b); Supplementary Affidavit of Arthur G. Baumann, (R. 3b)].

(2) Additional proceeds of said judgment that might be needed to pay off the balance due under said promissory note as a result of the accumulation of interest thereon.

"UPON CONDITION, HOWEVER, that upon the payment to the Assignee of the said sum of $8554.44 plus interest due under the terms of said note in full either from the proceeds of said judgment and/or from any other source or sources, this assignment shall be null and void, and the Assignee shall, thereupon, reassign, without recourse, to the Assignor, the amount of said proceeds then remaining uncollected.

"And, until the happening of the contingencies specified in the aforesaid condition, the Assignor hereby empowers the Assignee to collect and receive the amount of said proceeds assigned herein."

3. On March 2, 1953, the United States assessed withholding and excise taxes against Davis in the amount of $4,633.72, and in August and September, 1953, assessed further withholding and excise taxes of $5,136.82 and $232.89 against Davis. The United States claims $12,044.32, with interest, out of the Fund under the provisions of Sections 3670, 3671 and 3672(a) of the Internal Revenue Code of 1939.

4. On July 2, 1952, Embry Bros., Inc., leased to Davis certain equipment at an agreed rental of $8,270 payable in monthly installments of $344.58. Davis thereafter defaulted on the lease and abandoned the equipment which was repossessed by Embry Bros., Inc. Embry Bros., Inc., is asserting an equitable lien in the amount of $1,128.80, with interest from October

26, 1952, against the Fund, and James Drury is asserting a claim in the amount of $725 and interest thereon from April 6, 1952, which arises from facts similar to those on which the claim of Embry Bros., Inc. is founded.

5. On or about December 6, 1956, this Court found that counsel for Davis held a prior and superior lien for their attorneys' fees in a total amount of $6,666.66 to be paid out of the Fund, and the amount in the Fund was thereby reduced to, and presently amounts to, $13,333.34."

After a full hearing on the priority of the respective claims of Citizens Fidelity, the United States and Embry Bros. against the balance of $13,333.34 remaining in the Fund (R. 5a) the District Court, in its Discussion and Conclusions of Law (R. 26a-29a) found that (1) Citizens Fidelity held a prior assignment and lien against $9,000 out of the Fund; (2) the United States held a tax lien on the balance of the Fund (as the amount of the tax lien exceeded the balance left in the Fund); and (3) Embry Bros. were general creditors and held no lien whatever on the Fund.

On September 4, 1957, the District Court entered its Judgment pursuant to its decision.

On October 10, 1958, this judgment was *affirmed* by the United States Court of Appeals for the Sixth Circuit.

On February 4, 1959, the Petitioners' petition for rehearing was denied.

ARGUMENT.

FIRST POINT.

No Special and Important Reasons Exist for Granting a Reveiw on Writ of Certiorari.

The judgment of the District Court, summarily affirmed by the United States Court of Appeals for the Sixth Circuit, involved solely a question of the relative priorities between a bank, the United States and a lessor of equipment to a fund paid into Court in settlement of litigation between a contractor and his subcontractor. The District Court found that the claim of the Bank was superior to the tax claim of the United States, and that the claims of the Bank and of the United States were both superior to the claim of the equipment lessor. The United States was satisfied with this decision and did not appeal. On an appeal by the equipment lessor to the United States Court of Appeals, the judgment of the District Court was summarily affirmed. The equipment lessor filed a petition for rehearing which was denied.

The decision of the United States Court of Appeals did *not* conflict with the decision of another United States Court of Appeals on the same matter; it did *not* decide an important state question in a way in conflict with applicable state law; it did *not* decide an important question of Federal law which had theretofore not been settled by this Court; it did *not* decide a Federal question in a way in conflict with any decision of this Court; it did *not* depart from any accepted

course of judicial proceeding; and the question it decided was *not* one of great public or private importance.

SECOND POINT.

Where Federal Jurisdiction Is Based on Diversity of Citizenship, the Petitioners Cannot Demand That a United States Court Create an Equitable Lien Not Provided by Act of Congress and Not Allowed Under Kentucky Law.

1. The rule of *Erie R. R. Co.* v. *Tompkins*, 304 U. S. 64, required the United States Courts below (a) to apply any applicable Federal statute or (b) to follow the law of Kentucky.

The Petitioners in their briefs and argument in the Court of Appeals and in their Petition for Rehearing urge the courts of the United States to (i) disregard the provisions of The Miller Act [49 Stat. 793, *et seq.*; 40 U. S. C.; 40 U. S. C. A., §§ 270(a)-(d)], and the common law and statutes of Kentucky, and (ii) create a new theory of an equitable lien so as to prefer two unsecured general creditors to an assignee for value and to a valid tax claim of the United States.

Any application by a United States Court of the novel "equitable" theory demanded by Petitioners (i) would completely alter well established principles governing the priority of conflicting rights to a private fund of money in violation of the laws of Kentucky, and (ii) would be completely contrary to this Court's ruling in *Erie R. R. Co.* v. *Tompkins*, 304 U. S. 64; *Guaranty Trust Co.* v. *York*, 326 U. S. 99; and *West* v. *A. T. & T. Co.*, 311 U. S. 223, 237.

In the *Guaranty Trust Co.* case, *supra,* this Court said (at page 109):

> "* * * Erie R. Co. v. Tompkins was not an endeavor to formulate scientific legal terminology. It expressed a policy that touches vitally the proper distribution of judicial power between State and federal courts. In essence, the intent of that decision was to insure that, in all cases where a federal court is exercising jurisdiction solely because of the diversity of citizenship of the parties, the outcome of the litigation in the federal court should be substantially the same, so far as legal rules determine the outcome of a litigation, as it would be if tried in a State court. The nub of the policy that underlies Erie R. Co. v. Tompkins is that for the same transaction the accident of a suit by a nonresident litigant in a federal court instead of a State court a block away should not lead to a substantially different result."

In the *West* case, *supra,* this Court said:

> "Since the equitable relief sought in this suit is predicated upon petitioners' legal rights growing out of respondent's unlawful transfer of the stock to the assignee of the life tenant, the state 'laws' which, by § 34 of the Judiciary Act of 1789, c. 20, 28 U. S. C., § 725, are made 'the rules of decision in trials at common law' define the nature and extent of petitioners' right. See Russell v. Todd, 309 U. S. 280, 289. And the rules of decision established by judicial decisions of state courts are 'laws' as well as those prescribed by statute. Erie Railroad Co. v. Tompkins, *supra,* 78. True, as was intimated in the Erie Railroad case, the highest court of the state is the final arbiter of

what is state law. When it has spoken, its pronouncement is to be accepted by federal courts as defining state law unless it has later given clear and persuasive indication that its pronouncement will be modified, limited or restricted. See Wichita Royalty Co. v. City National Bank, 306 U. S. 103, 107. But the obvious purpose of § 34 of the Judiciary Act is to avoid the maintenance within a state of two divergent or conflicting systems of law, one to be applied in the state courts, the other to be availed of in the federal courts, only in case of diversity of citizenship. That object would be thwarted if the federal courts were free to choose their own rules of decision whenever the highest court of the state has not spoken."

2. The Miller Act [49 Stat. 793, *et seq.*; 40 U. S. C.; 40 U. S. C. A. §§ 270(a)-(d)] is the only applicable Federal statute. It does not create, and does not purport to create, any lien in favor of the Petitioners.

The Miller Act provides that in certain contracts with the United States the contractor shall furnish a *payment bond* "for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of each such person". The Act provides that every person who has furnished labor or material under such a contract and who has not been paid in full therefor shall have the right to *sue in the name of the United States* on the payment bond. It also provides that subcontractors shall have a right of action *upon the payment bond* on their giving written notice to the contractor.

Neither the Miller Act itself, nor the decisions interpreting it, create any lien in favor of the contractor or subcontractor for whose protection the *payment bond* provisions of the Act are designed.

The claim asserted by Embry Bros. is *not* an action on a Miller Act payment bond and is *not* an action *relating to funds over which the United States has any control.* It is solely an action attempting to establish a prior lien on a fund paid into Court in compromise of litigation for breach of contract between a contractor and a subcontractor. The District Court* fully recognized this and disposed of the Embry Bros. claim in the following words:

> "* * * There is no authority to support their (Petitioners') contention that the 'rather vague obligation' stated in Belknap Hardware and Manufacturing Co. v. Ohio River Contracting Co., 271 Fed. 144 (6th Cir.) as being assumed by the United States to look after the interests of laborers and materialmen and which is referred to in United States v. Munsey Trust Co., 332 U. S. 234, page 240, as the 'peculiarly equitable claim', has any application to funds in which the United States has no interest and over which it can exercise no control. * * *"

The Court of Appeals, in its Summary Opinion† found that the foregoing conclusions of law of the District Court "rest upon a sound basis".

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*R. 28a-29a.

†Petitioner's Brief, Appendix "A".

In the arguments below, Petitioners claimed an *equitable lien* and cited *Belknap Hardware and Manufacturing Co.* v. *Ohio River Contracting Co.*, 271 Fed. 144 (6th Cir.); *Seaboard Surety Co.* v. *Spear*, 119 F. 2d 849; *Henningsen* v. *United States Fidelity & Guaranty Company*, 208 U. S. 404, 28 S. Ct. 389, 52 L. E. 547; and *United States* v. *Munsey Trust Co.*, 332 U. S. 234, in support of their contentions.

In *Bank of Arizona* v. *National Surety Corporation*, 237 F. 2d 90 (9 Cir., 1956), the Court of Appeals thoroughly discussed the application of the Miller Act and the theory of "equitable liens", cited and analyzed all the pertinent authorities (including the *Belknap, Henningsen* and *Munsey Trust Co.* cases, *supra*), held that whatever "equitable lien" may perhaps exist under the *Belknap* and *Munsey Trust Co.* cases is specifically limited to those cases where the *contract proceeds are in the control of the United States*, and came to the same conclusion as the District Court and the Court of Appeals below.

The present case is even one step further removed from the *Bank of Arizona case*, since no contract proceeds under the control of the United States are involved and no contract proceeds representing money paid by the United States to the contractor are involved—the only money involved is the balance of $20,000 paid by Bateson into Court in settlement of a private litigation with Davis. Petitioners have *neither* shown nor alleged that the $20,000 was derived, in whole or in part, from the contract between Bateson and

the United States.* It was purely a payment made by Bateson to Davis in settlement of a breach of contract suit, and, as such, is wholly unrelated to, and distinct from, any payments which may or may not have been made by the United States to Batson in connection with Bateson's Government contract.

3. Neither the Common Law nor the Statutes of Kentucky create an equitable lien in favor of Embry Bros.

(a) No Mechanics or Materialmen's liens exist at Common Law.

Embry Bros. assert that the contracts were executed and performed in Kentucky and claim that they are entitled to a lien under Kentucky law. If Embry Bros. are entitled to any lien under Kentucky law it must be a *statutory* lien as no such right ever existed at Common Law or in equity. In *Powers* v. *Brewer,* 238 Ky. 579, 584, 38 S. W. 2d 466, the Court of Appeals said:

> "Although mechanic's liens were clearly defined and regulated in the civil law they were *not recognized at common law nor allowed in equity,* and therefore in this country the right to acquire and enforce such a lien is a creation of and dependent upon statute."

The United States District Court for the Western District of Kentucky has also recognized that mechanics' liens are purely statutory:

> "Such liens were clearly defined and regulated in the civil law, but found neither life nor vitality

*R. 16a-20a.

in the common law or equity. The right in Kentucky is purely statutory and, unless the facts bring the claimant reasonably within the terms of the statute, no lien exists." *In re Louisville Daily News & Enquirer*, 20 F. Supp. 465, 566; *Granger & Co.* v. *Riley*, 201 F. 901 (6 Cir.).

(b) The Kentucky Mechanics and Materialmen's Lien Statutes grant no lien to Embry Bros. as a claim for rent due the owner of leased equipment is "not a lienable claim" under Kentucky Statutes.

Embry Bros.' claim is for unpaid rental of equipment (R. 16a-20a). This is their *sole* claim and is the *only* basis for their claim to a lien. **But this is completely fatal to their cause as under the Kentucky Mechanics and Materialmens' lien statutes a claim for rent due to the owner of leased equipment is "not a lienable claim under our statutes."** *Steele & Lebby* v. *Flynn-Sullivan Company*, 245 Ky. 772, 776, 54 S. W. 2d 325; *Henry Bickel Co.* v. *National Surety Co.*, 156 Ky. 695, 161 S. W. 1113, 1114; *Century Indemnity Company of Chicago, Ill.* v. *Shunk Mfg. Co.*, 253 Ky. 50, 68 S. W. 2d 772; *Marion Steel Shovel Company* v. *Union Indemnity Company*, 255 Ky. 817, 75 S. W. 2d 541; *Thew Shovel Company* v. *Massachusetts Bonding & Insurance Co.*, 261 Ky. 712, 88 S. W. 2d 960.

THIRD POINT.

Petitioners May Not Raise for the First Time in Their Petition for Certiorari an Entirely New Question Not Presented to or Considered and Decided by the District Court and the Court of Appeals.

Petitioners now claim for the first time that the fund paid into Court by the general contractor (Bateson) belongs to them as third party beneficiaries of a contract between Bateson and Davis. This is a new question presented for the first time. This issue was not made in the trial court or on appeal to the Court of Appeals and the Court's judgment did not include any ruling on this issue. It is too late to raise such an issue on appeal or in a Petition for Certiorari. *Helvering* v. *Wood,* 309 U. S. 344, 349; *Helvering* v. *Tex-Penn,* 300 U. S. 481, 498; *General Utilities Co.* v. *Helvering,* 296 U. S. 200, 206, 207; *Hormel* v. *Helvering,* 312 U. S. 552; *DeWaters* v. *Macklin Co.,* 167 F. 2d 694, 699 (6 Cir.); *Delta Drilling Co.* v. *Arnett,* 186 F. 2d 481, 486 (6 Cir.).

CONCLUSION.

The issues decided in the District Court and affirmed by the Court of Appeals include no special or important questions of such public or private importance as to justify a review on Writ of Certiorari.

Even if some theory of a moral or equitable obligation on the part of the Government to see that suppliers of labor and materials to a subcontractor of a prime

contractor working on a government contract is so important as to justify review by certiorari, such moral or equitable obligation on the part of the Government can apply only to payments made from money withheld by the Government out of proceeds of contract moneys it owes to the prime contractor, and no extension of this by a United States Court is possible where such extension would conflict with the laws of Kentucky. *Guaranty Trust Co.* v. *York,* 326 U. S. 99; *Erie Railroad Co.* v. *Tompkins,* 304 U. S. 64; *Assn.* v. *Gates,* 66 F. Supp. 706.

The Petition for Writ of Certiorari should be denied.

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